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MAY 2025

Market Perspectives: Talk of the Town

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MARKET PERSPECTIVES: TALK OF THE TOWN

"At heart, 'uncertainty' and 'investing' are synonyms."

~ Benjamin Graham (famed U.S. investor, 1894-1976)

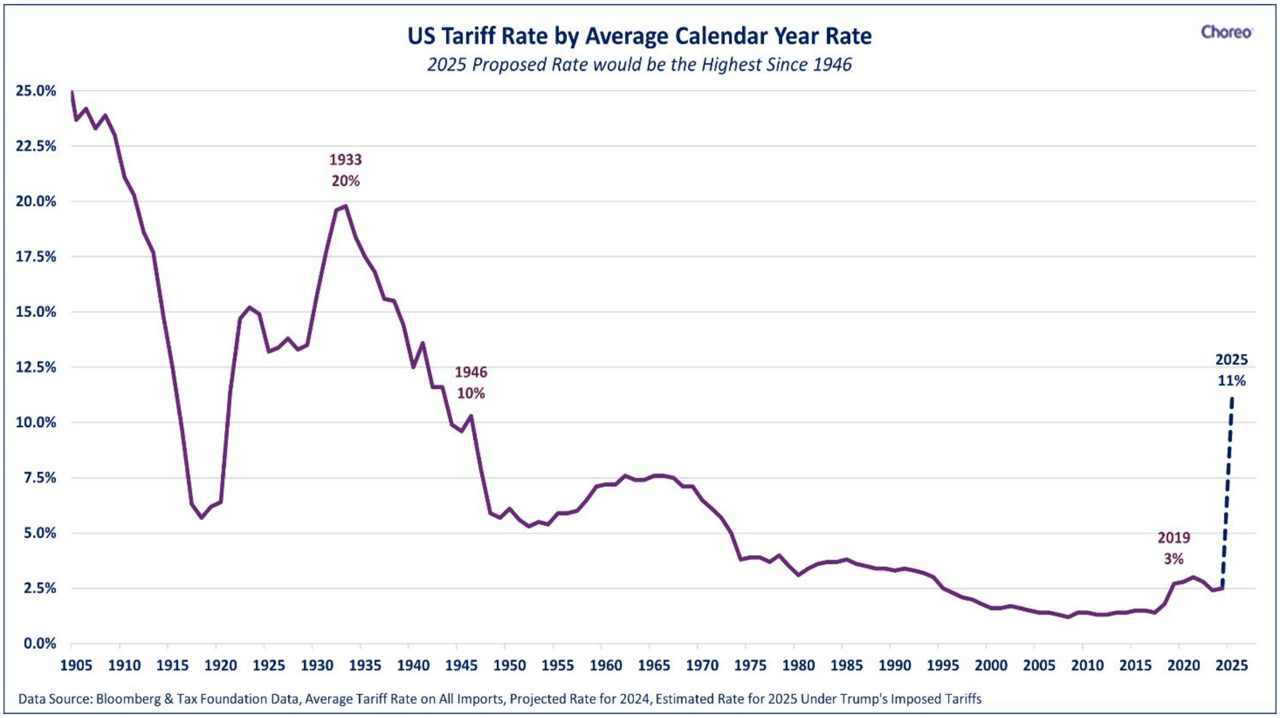
- After equity market volatility dominated headlines in April, due in large part to the unexpected breadth of sweeping tariffs, volatility pressures have been tempered by an easing of trade rhetoric from the Trump administration and optimism for trade deals to be negotiated.
- Despite an influx of economic data signaling caution – namely soft data such as sentiment surveys (consumer sentiment, CEO confidence, and small business uncertainty) and manufacturing surveys (ISM and regional Federal Reserve) – hard data (labor and productivity) has remained resilient.
- Across the globe, fiscal and monetary authorities remain focused on subduing inflation, while promoting growth.

It is rare that relatively obscure financial issues such as tariffs and trade imbalances make their way into discussions on youth sports fields, dinner get-togethers, and birthday parties. But this is 2025! The start of 2025 has been littered with swirling economic news flow that has become the talk of the town. There are major, obvious questions such as: "What will the path of trade policy be?" and "How will changes impact the economy and markets?" Naturally, beneath the surface, other important questions are emerging. These questions (and more) as well as the potential implications of the uncertainty surrounding the issues du jour are worthy of a deeper examination.

Tariffs: International trade has been a centerpiece of the Trump Administration's policy agenda, dating back to his speech at the Republican National Convention, when he floated the idea of using tariffs as a tool to address trade imbalances. That idea began taking shape earlier this year before sweeping tariffs were introduced on April 2, 2025. Along the way, tariffs have contributed to heightened market volatility and broader economic uncertainty. Today, many of those proposed tariffs are on pause as trade negotiations continue.

Why is it important: After decades of relatively low tariff rates, the average tariff rate on U.S. imports is poised to rise (see chart below). The outcome will largely depend on how trade negotiations unfold. So far, the biggest economic impact has been heightened uncertainty for consumers and businesses. The broader effects on growth, inflation, and productivity remain unclear, as key questions around scope, targets, and strategic initiatives behind these tariffs are still unanswered. Additionally, supply chain disruptions could materially impact many other aspects of the lives of Americans (and people around the world).

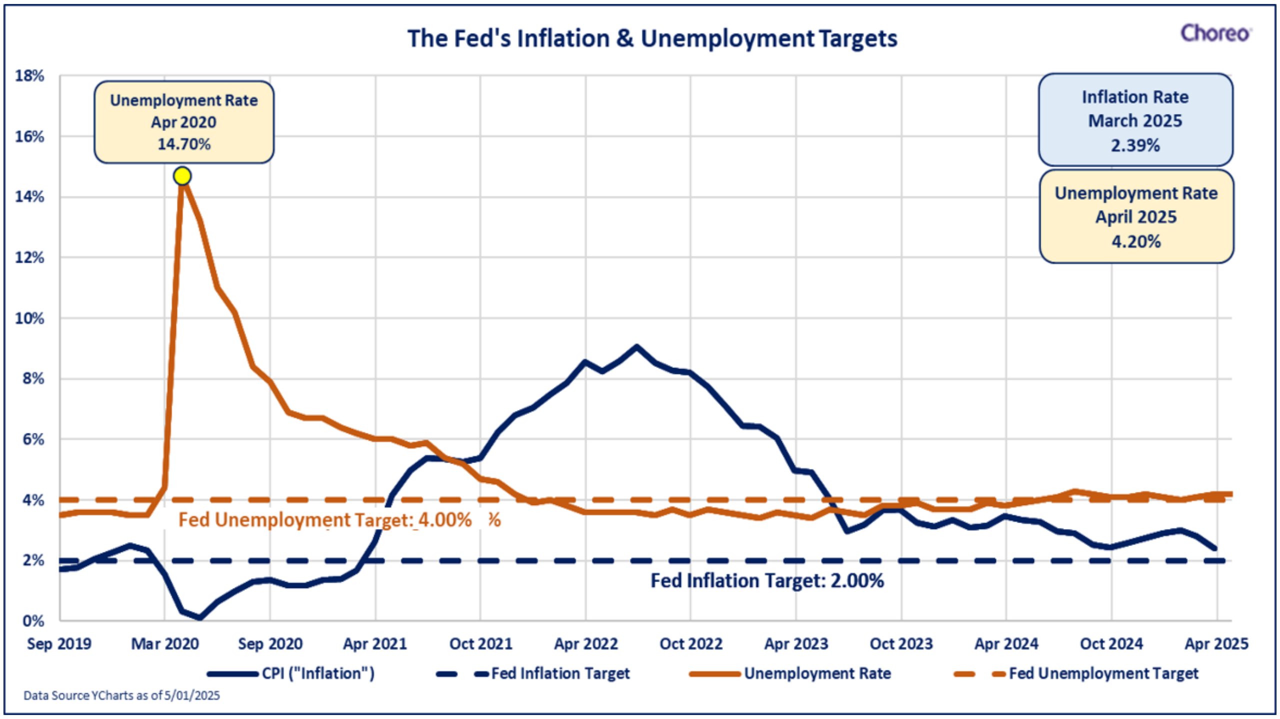
What are we watching for: Progress in negotiations, ideally, and for clarity on the scope and intent of new trade policies. The response from major trading partners will also matter. If uncertainty persists or escalates, it could weigh more heavily on business investment, supply chains, and pricing (e.g., we are already seeing the early signs of port disruptions). On the other hand, clearer policy direction could help markets and businesses adjust (in some cases, this is already occurring).



<u>The Fed Mandate</u>: The Federal Reserve (the "Fed") plays a central role in shaping economic conditions through its dual mandate: promoting maximum employment and maintaining stable prices. The Fed sets monetary policy (distinct from the government's fiscal policy) and influences the economy primarily via interest rates. When the economy is growing, unemployment is generally low, and inflationary pressures build, the Fed typically raises rates to cool the pace of expansion to temper inflation and maintain price stability. Conversely, during periods of contraction – when unemployment rises, and inflation subsides – the Fed may cut rates to stimulate growth and promote hiring.

Why is it important: The Fed's decisions have far-reaching implications. As the cost of borrowing changes, asset prices, business investment, and consumer spending will fluctuate based on the availability and cost of capital. At its core, the Fed seeks to balance supporting economic growth while keeping prices in check.

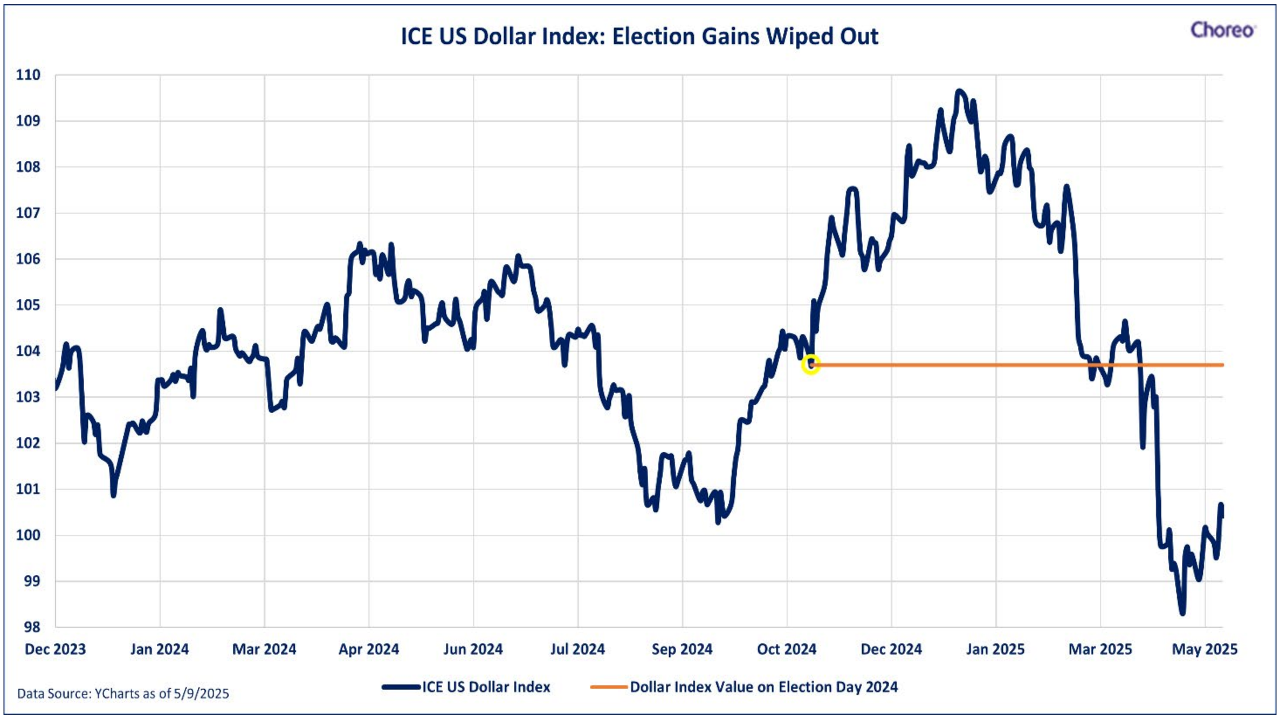
What are we watching for: Inflation has eased materially from its peak of 9.2% in June 2022 but remains above the Fed's target of 2%. The labor market continues to gradually cool from a position of strength. Entering 2025, consensus estimates were for steady economic growth (2.5%-3.0%) and continued inflation moderation. This would imply the Fed's dual mandate was coming into balance, setting the stage for potential rate cuts. However, trade tensions and policy uncertainty have introduced challenges to the outlook. Tariffs could either slow growth (prompting rate cuts) or push prices higher (limiting the Fed's ability to ease or potentially even prompting rate hikes). What the Fed does next will largely depend on how growth, inflation, and the labor market evolve. Accordingly, we are closely monitoring these three variables. The chart below notes the Fed's dual mandate and the progress as it stands now.



Currency Fluctuations: Currencies don't always make headlines but shifts in exchange rates can have meaningful effects shaping trade, investments, and inflation. The recent focus of U.S. trade policy (tariffs, reshoring of manufacturing, and job creation) have brought currency fluctuations into focus, especially as the U.S. dollar has weakened substantially to start the year as shown in the graph below of the U.S. Dollar Index.

Why is it important: Currency moves can influence just about everything – and they may have a more significant impact than many consumers and businesses realize. If the dollar strengthens, U.S. goods become more expensive to foreigners – because it takes more of their now weaker currency to buy the same American products. That can negatively impact U.S. exports and the companies behind them. On the other hand, a weaker dollar makes U.S. goods more competitive abroad, which helps U.S. multinational companies that generate sales overseas. It can also support broader domestic policy goals like reshoring production and boosting domestic job creation.

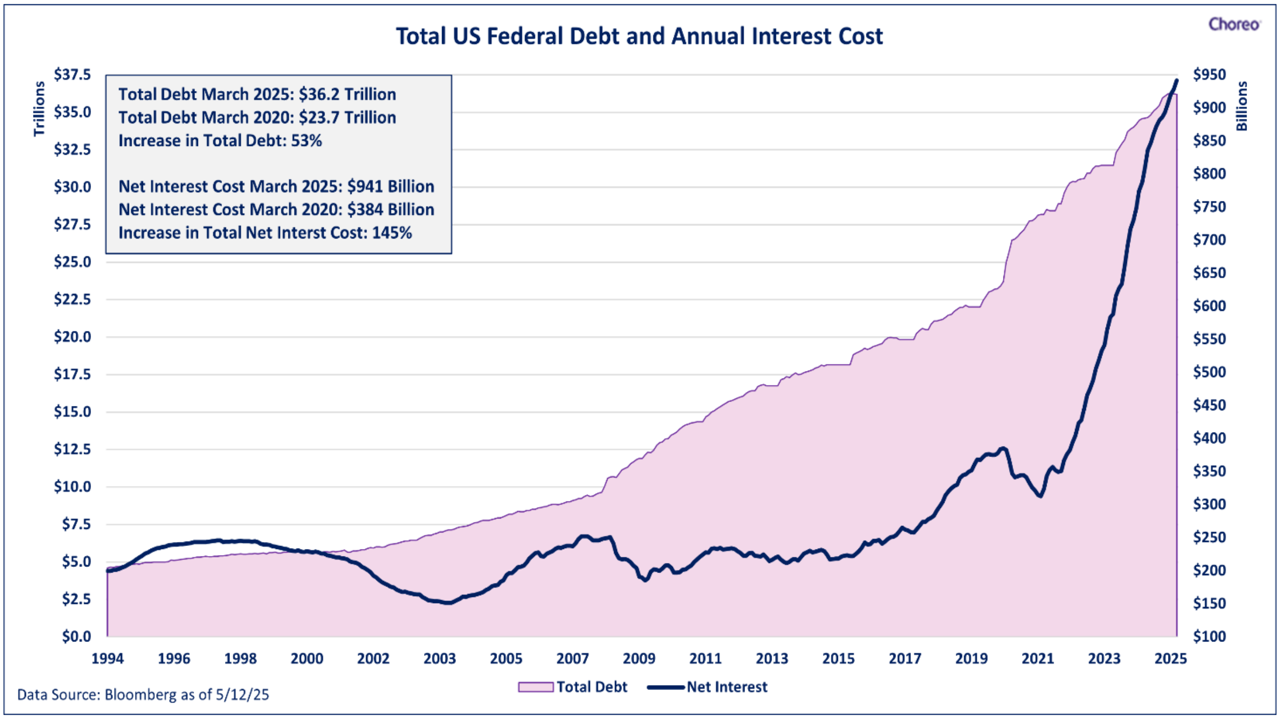
What are we watching for: The U.S. Dollar remains the global reserve currency. For investors, a weakening dollar has helped boost returns on international holdings in 2025; though, importantly, currency trends can shift quickly. Global central banks' policy responses to growth and inflation are the critical factors within control, as well as the calming of currency volatility. These factors may rest on whether trade deals will have a lasting impact on currencies. A graph of the Dollar Index (comprised of various global currencies) is presented below. The swings of the index year to date have been extreme.



<u>Deficits and debt levels:</u> The U.S. government has run a persistent budget deficit and accumulated debt to fund their spending for many years. At year-end 2024, U.S. government debt was $34 trillion, compared to the overall size of the U.S. economy of $30 trillion. Some of this debt accumulation stems from spending on programs like Social Security, Medicare, and Defense while an additional increase was felt from spending during the Covid pandemic. Regardless of the cause, there is growing attention to the sustainability of running deficits and the long-term implications of such large debt levels.

Why is it important: Rising debt levels are a complex concept, and the implications are widespread. As interest rates rise, the cost to borrow rises, making the cost to service the $34 trillion debt load more expensive (which is playing out currently, shown in the graph below). More dollars spent on servicing interest payments may mean the government has less flexibility to respond to future downturns (when they would traditionally increase spending to stimulate the economy) or invest in growth-oriented initiatives. Too much debt can crowd out private investment (if interest rates rise, the cost for businesses and entrepreneurs to borrow for investment purposes increases), dampen productivity, and pressure future spending decisions. Over a shorter time frame, concerns about debt can drive volatility in the bond market.

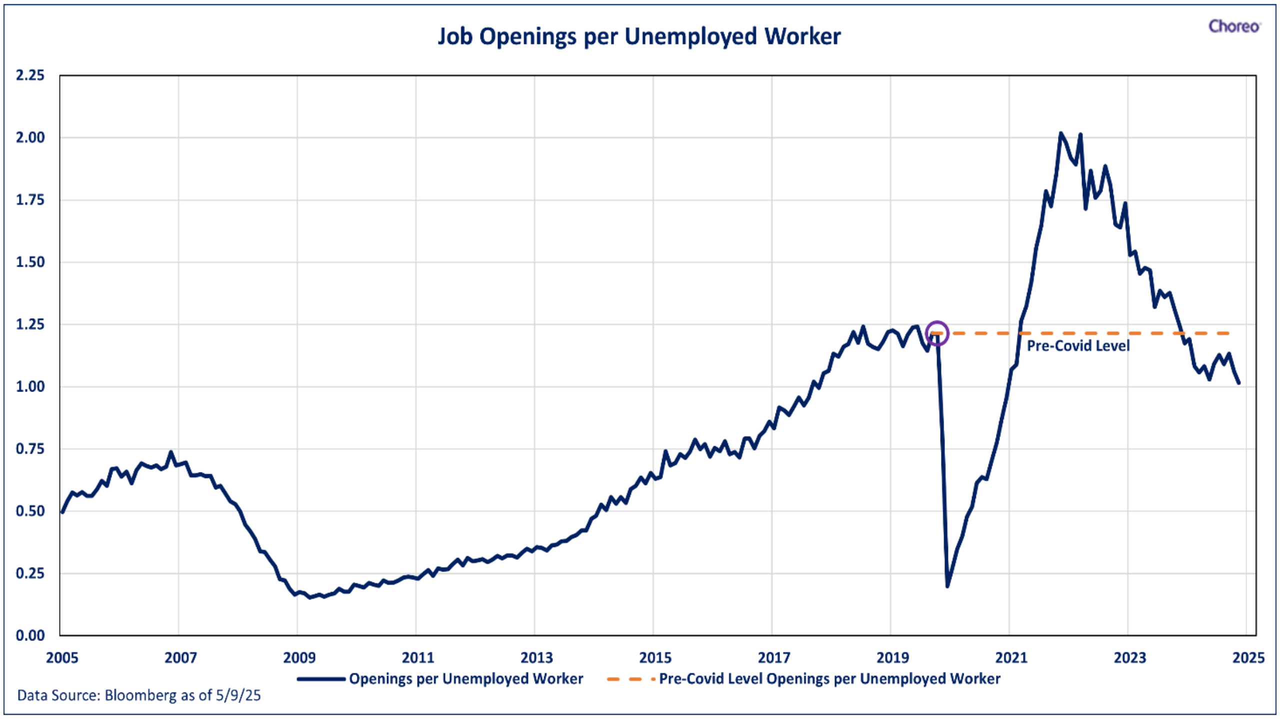
What are we watching for: Treasury issuance and how the market absorbs new issues is one of many factors to watch. As has been the case, there remains strong demand for Treasuries. Overall interest rate levels provide an indication of demand for U.S. debt and can also provide signals. $9 trillion of U.S. government debt will mature in 2025, some of which was issued at much lower interest rates. In other words, as the lower cost debt is refinanced, it will be more expensive to service. The ongoing success of the refinancing actions will be worth watching.



Employment: The labor market is one of the most closely watched parts of the economy. A healthy job market supports income, spending, and overall consumer confidence. As a reminder, consumer spending accounts for about two thirds of economic activity, meaning a strong labor market may coincide with strong consumer spending.

Why is it important: The labor market plays an important role in shaping inflation and monetary policy. For the last few years, strong wage gains have helped offset some of the impact of higher prices, and solid job creation has kept unemployment low. When the job market becomes strained (i.e., too tight with too few workers to fill jobs), it can lead to higher inflation. This can be a challenge for policy makers. The traditional action would be to increase interest rates to reduce aggregate demand which should contain inflation. On the other hand, overtightening (i.e., raising interest rates by too much) can cause job losses and hurt the economy as consumers will not have money to spend.

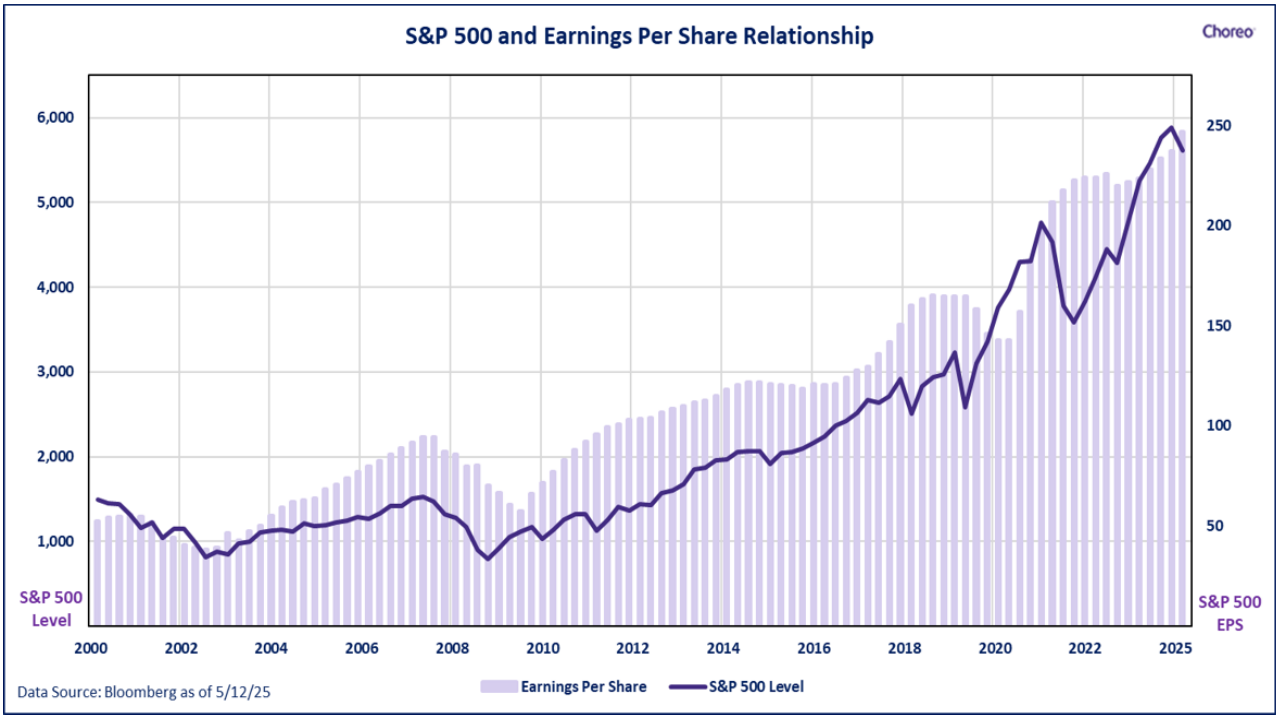
What are we watching for: The labor market has been gradually normalizing since mid-2022. Job gains have slowed, wage growth has moderated, and job openings are trending lower (as shown in the graph below). At one point, the ratio of job openings for each person looking for a job was roughly two. This has fallen to a still strong one job opening per unemployed worker, a normalization of conditions. We are watching a number of labor data points, (payrolls, wages, unemployment rate, labor force participation, and immigration) for signals of health in the labor market and its potential knock-on effects for the broader economy.



<u>Corporate Earnings:</u> The correlation over time between prices and profits is strong. Corporate profits are the lifeblood of valuations and often tell us more about economic reality than macroeconomic data alone. While economic headlines tend to focus on inflation, rates, or politics, earnings tell us how businesses are actually performing and whether consumers are spending, costs are rising, and growth is still intact.

Why is it important: At the core, a company's ability to adapt and execute strategically will typically drive profits. Strong earnings growth supports equity markets over the long run. In the short-term, earnings can be overlooked by investors, at least for awhile, particularly when the news headlines become powerful. For investors with a long-term focus, earnings growth will provide support and confidence. When earnings slow down, however, volatility can rise, leading to investor uncertainty for the road ahead.

What are we watching for: Earnings have consistently grown in major U.S. indices, like the S&P 500, post-Covid (although the index has been led by the mega-cap technology companies). A broadening of earnings growth could help sustain the bull market. Additionally, after years of navigating COVID, inflation, and tech disruption (and now tariffs), how well corporate America adapts to a new trade environment could also play an important role shaping earnings growth from here. Quarterly earnings reports remain an important scorecard for investors' as well as companies' outlooks often associated with these reports. The graph below shows the S&P 500 growth in profits in recent years.



Conclusion

If investment related topics enter the conversations for most Americans, it typically means something unusual is afoot. In this case, tariff talk (as well as some of the other topics described above), and the impact of these topics has become a more widespread discussion point. Higher levels of uncertainty generally will cause higher levels of volatility. Remaining focused on a solid, disciplined long-term plan can help with these discussions and provide a winning outcome. As we sort out these uncertain times, as always, please reach out with any questions.

Index Definitions

Index Definitions S&P 500 Index is a capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Disclosures